No. 935

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In the Supreme Court of the United States

OCTOBER TERM, 1922.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE,
Petitioner,

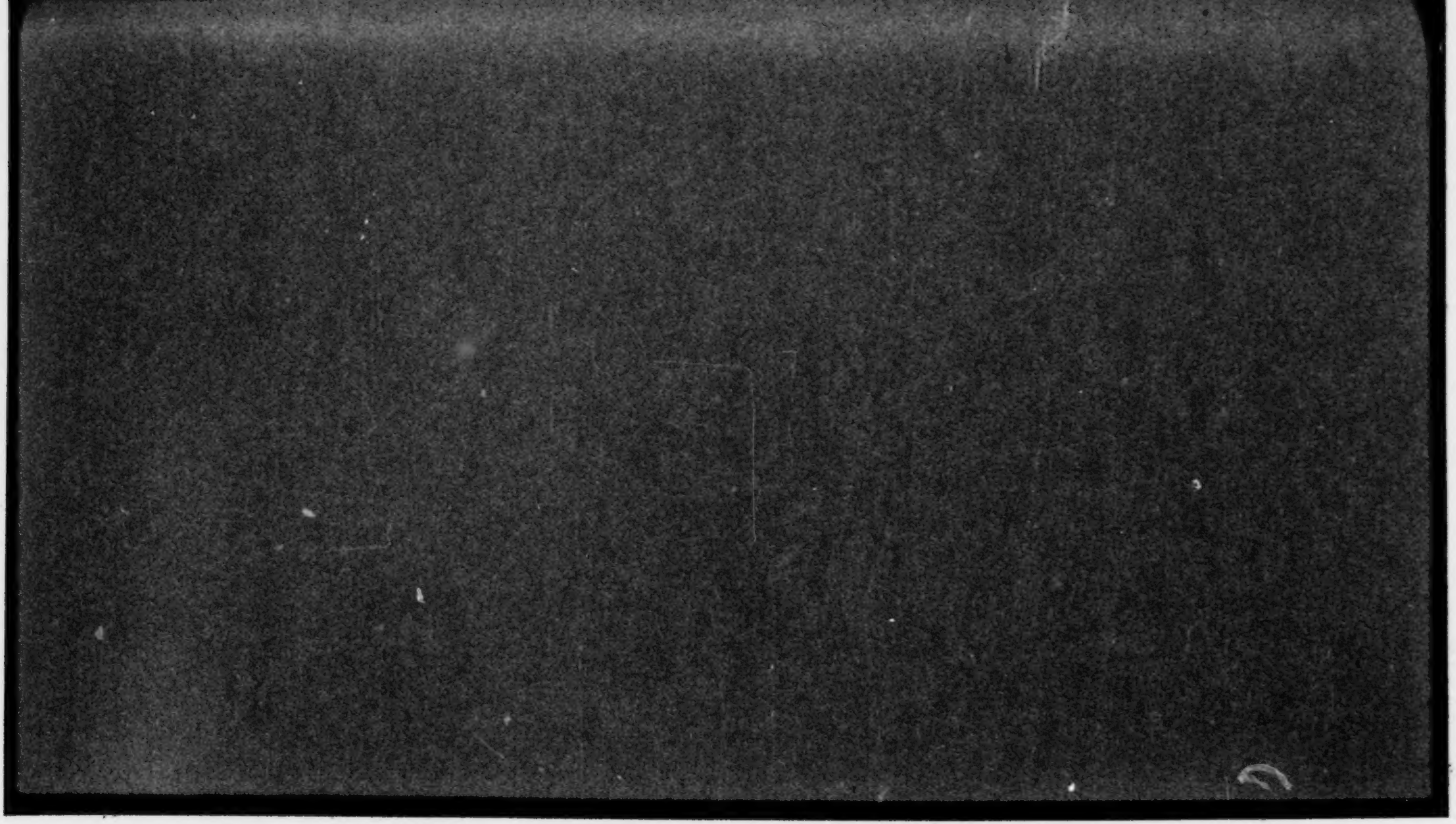
vs.

LOUIS STEARN,
Respondent.

BRIEF OF RESPONDENT, LOUIS STEARN, IN OPPOSITION TO PETITION FOR CERTIORARI.

THOMPSON, HINE & FLORY,
Attorneys for Respondent.

CHARLES P. HINE,
Of Counsel.



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BRIEF OF RESPONDENT, LOUIS STEARN, IN OPPOSITION TO PETITION FOR CERTIORARI.

I.

The case is not one of general public interest or importance. It turns on the construction of the language of a long and complicated contract, and the steps taken to carry out such contract, and will therefore be of little or no value as a precedent in cases involving other companies. The opinion of the District Court states:

> "Whether or not the plaintiff is entitled to recover depends upon the correct understanding and meaning of the agreement in writing, dated November 8, 1916, executed by W. D. B. Alexander, A. W. Henn and E. C. Henn, parties of the first part, and Eastman, Dillon & Company, of New York, parties of the second part."

II.

The Statement of Fact in the brief in support of the petition that there was a sale by stockholders of all of their stock, is not correct, as appears from the following quotation from the opinion of the Circuit Court of Appeals:

> "There was nothing that can properly be called a sale of one-half the stock under consideration in any aspect of the case."

III.

The tax which the government collected from stockholders in The National Acme Manufacturing Company was based on an entirely fictitious profit. Those stockholders who still hold their stock in The National Acme Company retained one-half of their original capital investment just as truly as if they still held one-half of their original certificates in The National Acme Manufacturing Company. It is grossly unjust that such stockholders should be taxed as if they had sold such original interest at the rate of Three Hundred Dollars ($300.00) per share. It is unjust that stockholders who have actually sold their new certificates at Twelve or Fifteen Dollars per share during the past few years should be taxed on the basis of having realized Thirty Dollars ($30.00) per share in 1916. As to such stockholders, the government first charges them with a fictitious profit and then is obliged to allow them a fictitious loss. No question of general interest or of great importance to the government is presented since

1. The case affects only a few stockholders of a single corporation, i. e. those who have preserved their rights by filing claims for refund and by commencing

suit. The statute of limitations has run against other stockholders.

2. The decision does not prevent the imposition of taxes on all profits realized from the transaction involved, but requires the imposition of taxes as and when such profits are realized.

3. The decision below, even if it is applicable to other reorganizations, can affect the liability of taxpayers only for the years prior to 1918, since the Revenue Acts of 1918 and 1921 specifically provide that no taxable income is realized as a result of such reorganizations.

IV.

The Solicitor of the Internal Revenue Department and the District Attorney contended in the Court of Appeals that the case was governed by *United States vs. Phellis*, 257 U. S. 156, and other cases cited in the brief of the petitioner in this Court. Such contentions, as the court will see by examination of the opinion of the Circuit Court of Appeals, were fully considered by that court. That court said:

> "Except for change of corporate entity there was here a continuance of the same concern. The assets were the same, and the stockholders (assuming the sale of the other half to have been consummated) were the same, and in the same proportions; the domicile, the powers, the name, substantially, and the corporate obligations were all left as before. *The same ends might have been achieved by an amendment of the articles of incorporation providing for the increase of the capital stock, the reduction of the face value of its shares, and the change of name. Had this method of accomplishing the identical result been pursued, the*

increase in face value of the new certificates issued to the holders in exchange for the old would have been plainly a mere stock dividend, non-taxable under Eisner vs. Macomber, 252 U. S. 189. Therefore, if the transaction be taxable it must be because of the giving up of the old and the taking on of the new charter. It is true that a new corporate being has intervened, but where a corporate entity had been found to be a mere matter of form, it has been disregarded in similar transactions in respect to income taxation. *Southern Pacific Co. vs. Lowe*, 247 U. S. 330; *Gulf Oil Co. vs. Llewellyn*, 248 U. S. 71; *Alpha Portland Cement Co. vs. United States*, 261 Fed. 339; although it is not so when it is a matter of substance. *Eisner vs. Macomber* and *United States vs. Phellis, supra.* The latter case, strongly relied upon by plaintiff in error, does not present a parallel situation. There the surplus had been separated from the capital for the purpose of distributing it among the stockholders in the form of the stock of a new corporation to which the assets were conveyed. But the old corporation continued to exist, its stock remained outstanding, and the segregation of capital from surplus was accomplished by setting over to it assets equal to its capital stock and capable of returning future dividends to its stockholders. * * * *Peabody vs. Eisner*, 247 U. S. 347, exhibited the case of a distribution, as a dividend, of the stock of another corporation held by the parent company. In each of those cases there was a segregation of accumulated surplus and a distribution of it in the stock of a corporation other than the parent company, both corporations continuing to exist.

In the present case there has been no attempt on the part of the concern to segregate or distribute its surplus, but merely a reorganization accompanied by a stock dividend. It has not been divided into two corporations, one to hold the capital, the

other to take the earnings, as in the cited cases. The old charter was surrendered when the new one was taken. The venture of the stockholder in the hazard of the business continues undivided. He has not drawn out his profit. His investment is still entirely in the same enterprise, albeit represented by new certificates, yet essentially the same." (Italics ours.)

That the points of difference between the facts of the *Phellis* case and the facts of the present case were numerous and important, appears from the following quotations.

In the *Phellis* case this Court stated:

> "Each holder of the New Jersey company's common stock, including claimant, retained his old stock, and besides received a dividend of two shares for one in stock of the Delaware company, and the New Jersey company retained in its treasury six per cent. debenture stock of the Delaware company equivalent to the par value of its own outstanding common stock."

In the present case the stockholders did not retain their stock in the old company, and the old company retained nothing in its treasury.

In the *Phellis* case this Court said:

> "After the reorganization and distribution of the stock of the Delaware company the New Jersey company continued as a going concern and still exists."

In the present case the old corporation was dissolved.

In its opinion in the *Phellis* case this Court, after pointing out that the new company was formed under the laws of a different state, and after mentioning many other facts which distinguish the facts of that case from the present, says:

"In the light of all this we cannot regard the new company as virtually identical with the old."

As pointed out in the above quotation from the opinion of the Circuit Court of Appeals, the same identical result which was achieved in the present case could have been accomplished by the amendment of the Articles of Incorporation of the old company, and the declaration of a stock dividend. It is conceded that no income would have been realized if the result had been reached through the medium of a stock dividend. The right of the Government to impose a tax on income depends on whether income has been realized. We maintain that the axiom that, "Things which are equal to the same thing, are equal to each other", is applicable in law, as well as in mathematics; that since this Court has held in *Eisner vs. Macomber*, 252 U. S. 189, that no income would be realized by the result of the transaction, the court cannot consistently hold that income has been realized when the same result is reached through another form of procedure.

Neither the 1913 nor the 1916 income tax laws contained any provision which dealt expressly with the subject of an exchange of property. It was left to the courts to determine whether, in any particular case, income had been realized through an exchange. The subject of taxable income from an exchange, is, however, dealt with in detail in the present revenue act, Section 202 (C); and we submit that that act expresses in the form of statute law, principles which should govern the Revenue Department, and the courts, in their construction of general language in former acts. We quote the portion of Section 202 (C) which expressly forbids the imposition of such a tax as that in the instant case.

"Sec. 202 (C) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—* * *

(2) 'When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected).'"

For the reasons above stated, we submit that there is no question of general interest, that there is no error in the judgment below, but that on the contrary, the decision is in accordance with the principles announced and applied by this Court in *Eisner vs. Macomber*, 252 U. S. 189, and *United States vs. Phellis*, 257 U. S. 156.

Respectfully submitted,

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